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TAGS: ECON EFIN EINV ETRD HK CH
SUBJECT: LEHMAN TRADING OPERATIONS SUSPENDED IN HONG KONG;
ECONOMISTS LOOK FOR MAINLAND STIMULUS PACKAGE

¶1. (SBU) Summary: Hong Kong's Hang Seng Index (HSI) closed down 5.4 percent on September 16, mirroring losses in other major global markets in the wake of Lehman Brother's bankruptcy. HK's market regulatory authorities suspended Lehman's stock and option trading licenses and restricted financial transactions by Lehman's operating subsidiaries, as the company's approximately 1,000 Hong Kong-based employees faced an uncertain future. The HKG's three top finance officials sought to reassure investors, while local economists told EconOff that the global economic crisis will deepen. The economists believe the PRC government will use its substantial financial reserves to cut taxes and boost government spending, as a means to sustain a high single-digit GDP growth rate. End summary.

Market Update

¶2. (U) Hong Kong's Hang Seng Index (HSI) lost as much as 1,333 points (6.9 percent) on September 16 -- a level last seen in October 2006 -- before late buying enabled the market to inch upward off its lows and close down 5.4 percent. HIBOR short term loan rates rose sharply from the previous trading day, reflecting market uncertainty. As quoted by Hang Seng Bank at 1754 HRS local time, the overnight and one-week rates both increased to 3.5 percent and exceeded the longer term HIBOR rates for the first time in recent memory. One-month, three-month and six-month HIBOR rates increased to 3.0 percent, 2.25 percent and 2.25 percent, respectively.

Lehman Brothers Trading Licences Suspended

¶3. (U) Following Lehman's Chapter 11 bankruptcy filing in New York, the Hong Kong Stock Exchange (HKSE) suspended Lehman's trading licenses in both the stock and options markets as of September 16, and disallowed Lehman's access to the HKSE's automated trading systems for shares and options. Hong Kong's Securities and Futures Commission issued "restriction notices" on financial transactions by Lehman's four major operating subsidiaries in Hong Kong, in order to preserve the assets of the companies and to protect the interest of the companies' clients and the investing public. (Note: The four entities are Lehman Brothers Asia Limited, Lehman Brothers Securities Asia Limited, Lehman Brothers Futures Asia Limited, and Lehman Brothers Asset Management Asia Limited. End note.)

¶4. (SBU) Lehman's SVP of Corporate Communications in HK, Matthew Russell, told EconOff on September 16 that Lehman employs approximately 1,000 individuals in Hong Kong. Lehman's HK staff is "greatly disappointed," he said. "We

all expected a different outcome, and we've only had a short timeframe in which to absorb the impact." Lehman's staff was told on September 16 that their salaries for September would be fully paid, and that their workdays would be cut in half until further notice.

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Soothing Words From Top Hong Kong Officials
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¶5. (U) Hong Kong's top three officials in charge of banking and financial affairs -- Financial Secretary John Tsang, Hong Kong Monetary Authority (HKMA) Chief Executive Joseph Yam, and Secretary for Financial Services and the Treasury K. C. Chan -- talked to the press in the morning of September 16, in an attempt to calm nervous investors. Tsang said, "The Hong Kong government has closely monitored the situation of Lehman Brothers and will ensure that the operations of the Hong Kong stock market are carried out in an orderly manner." K.C. Chan said, "Hong Kong has a good market regulatory system, and we have confidence that the regulatory organizations will guarantee that the stock market will conduct today's business smoothly."

¶6. (U) Meanwhile, Yam noted the obvious, telling local press that the bankruptcy of Lehman Brothers would have "negative impacts" on Hong Kong, and would result in market corrections here. Yam said he foresees stability in HIBOR and the pegged exchange rate of Hong Kong's dollar to the U.S. dollar. Yam stated that Hong Kong would not have liquidity problems, noting that the HKMA could provide funds to bolster the market, if necessary. He described the U.S. markets as

experiencing a "serious financial crisis," and he said developments related to Lehman Brothers in the next few days would be crucial. He made no reference to AIG's financial woes.

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China's Benchmark Rate Cut
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¶7. (U) Over the weekend, the PRC government announced a 27 basis point cut in its benchmark lending rate, announced as a means to assist small and medium-sized enterprises. Hong Kong-based market analysts agreed that the rate cut -- the first since 2002 -- was not designed to boost declining stock market shares. JP Morgan's Chief Economist Frank Gong interpreted China's rate cuts as a significant change in policy. He reiterated his opinion that a series of market stimulus measures would be launched soon by Beijing.

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Global "Armageddon Base-Case" Scenario
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¶8. (SBU) Anthony Lok, Head of Research at Bank of China in Hong Kong, told EconOff on September 12 that an "Armageddon base-case scenario" is the "most likely outcome" for the global economy over the next 12-18 months. Lok foresees the global economy entering a severe recession that will be exacerbated by USG actions to prop up its financial markets by "printing money, bailing out financial institutions, and giving tax breaks the government cannot afford." He believes this will weaken the U.S. dollar and create upward pressure on commodity prices and inflation, thereby forcing the Federal Reserve and European Central Bank to raise interest rates as residential home prices continue to slide during the envisioned recession. In contrast to Lok,s pessimistic outlook for the Western European and U.S. economies, he told EconOff that the Hong Kong market will be somewhat shielded from damage by its ever-closer economic relationship with the Mainland.

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HK Buffered by Integration with Mainland?
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¶9. (SBU) According to Lok, over 50 percent of the Hang Seng Index,s market capitalization is comprised of companies headquartered in the Mainland, and over 60 percent of HSI corporate revenues are sourced from the Mainland. Lok said falling oil and food prices in the Mainland have stemmed the PRC government,s immediate inflation concerns. He expects the Mainland to be less severely affected than Western markets by the coming global downturn, due to the PRC,s ability to use its substantial financial reserves for tax cuts and increased government spending.

¶10. (SBU) Lok,s comments were echoed by Grace Ng, Chief Economist for Greater China at JPMorgan in Hong Kong. She told EconOff on September 12 that the PRC government "is looking at 1998 as an example of the benefits of fiscal stimulus spending." Her 9.6 percent Mainland GDP growth forecast for 2009 assumes US$21.9 billion (150 billion renminbi) of tax cuts and US$36.5 billion (250 billion renminbi) of incremental PRC government spending on "infrastructure in major cities, and soft infrastructure projects such as health and human services." She said the PRC government views instability in foreign markets as a threat to national security, and that Beijing will "use its surpluses to boost internal demand, if we see a global recession."
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